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ABSTRACT

A committee report on the Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF) is presented, along with a five-page summary of the report. The full report addresses the specifics of various pensions issues, many of a technical nature, and focuses on the flexibility of the plans for TIAA-CREF policyholders. Two series of recommendations, along with comments, are included in the report. The summary provides a comprehensive overview of the Ad Hoc Committee's first 6 months of work. The Committee concludes that the investment vehicles in the present TIAA and CREF programs are not adequate to meet the needs of most individual participants. It is recommended that the rollover and transfer of funds from TIAA to CREF and to other retirement plans, and from CREF to other retirement plans, should be permitted at any time as a matter of general policy. Suggested changes in payout options include an increase in the Retirement Transition Benefit and a choice of installment payout. A wider variety of investment and risk alternatives are also proposed, such as a money market fund, publicly traded bonds, and a group of equity funds. TIAA-CREF issues that the committee should address in the future are identified. (SW)

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NACUBO First Interim Report on TIAA-CREF

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The NACUBO Board of Directors established in November 1983 the Ad Hoc Committee on TIAA-CREF. The Committee's mandate is to examine current TIAA-CREF policies, planned new programs, and certain operating practices, and then to propose specific policy changes, if any, that would be beneficial to the organization's large number of participants and their institutions. The first product of the Committee's work was a report that was reviewed and accepted by the NACUBO Board at a meeting in July.

Following are two separate documents. The first is a five-page summary of the full report. It provides a comprehensive overview of the Committee's six months of work, including the final policy recommendations to TIAA-CREF. The report itself, which discusses the specifics of various pension issues, many of a technical nature, deals almost exlusively with flexibility for TIAA-CREF policyholders. It reflects the Committee's particular concern with flexibility for "old money"--that is, funds already invested in the pension system. Two series of recommendations, along with comments, are included in the report.

Dialogue on these and other issues will continue between the NACUBO Committee and TIAA-CREF. Although this is the Committee's first report, it envisions future analysis and discussion of TIAA-CREF issues, some of which are part of the Committee's tentative agenda included in the following document.

HE017579

Members of the NACUBO Ad Hoc Committee on TIAA-CREF

Raymond M. Krehel, chairman, vice president for business and finance and treasurer, Colgate University; Harold R. Bland, vice president for business and finance, Roosevelt University; Donald H. Cole, vice president for business and financial affairs, Western Washington University; Lee A. Ellis, senior vice president for business and finance, Northwestern University; Hans H. Jenny, executive vice president, Chapman College; Orie E. Myers, Jr., vice president for business, Emory University; Roy A. Schotland, professor, Georgetown University Law Center; Robert M. Wilson, director, University Personnel Programs, The Johns Hopkins University. Counsel to the Committee: William T. Gibb, Caplin & Drysdale.

SUMMARY REPORT

In the last 10 years an entire financial services industry has been created around the rapid growth of new investment and tax-deferred retirement savings opportunities. Many individuals and a growing number of colleges and universities are taking advantage of these opportunities.

TIAA-CREF, higher education's largest pension system, has not adequately explored--or satisfactorily responded to--the policy innovations and the competitive new programs available today.

As a result, TIAA-CREF participants have become concerned over their comparative lack of options, during both the accumulation and payout stages.

This concern, publicly expressed by faculty and administrators, led NACUBO, in November 1983, to appoint this Ad Hoc Committee on TIAA-CREF. The Committee's primary purpose is to examine current TIAA-CREF policies, planned new programs, and certain operating practices, and then to propose appropriate specific policy changes, if any, that are believed to be beneficial for the organization's 750,000 active participants and 135,000 present retirees and beneficiaries.

The Committee's ultimate goal is to help improve and strengthen the TIAA-CREF pension system, thus returning it to its well-deserved historic leadership position in the pension industry. In the face of TIAA-CREF's currently limited investment and payout options, a number of higher education institutions have already added alternatives to their existing TIAA-CREF plans, and many more are considering new retirement options. But if TIAA-CREF responds appropriately it will continue as the centerpiece of college and university retirement programs.

Flexibility is the focus of the Committee's first interim report. More precisely, our focus and greatest concern is flexibility as it pertains to "old money," that is, the billions of dollars already invested and essentially locked up in the TIAA-CREF system, plus the several billion dollars each year in investment income.

With respect to "new money" (premiums yet to flow into TIAA-CREF), our interim conclusion is that new options are slowly being implemented. This finding is based on our review of recent TIAA-CREF new-product introductions and announcements and on our discussions with TIAA-CREF management concerning forthcoming options.

Unfortunately, we have to report that greater flexibility and product alternatives appear not to be even contemplated for longstanding TIAA-CREF participants and for that huge pool of "old money."

In addition to "old money" as distinct from "new money," there is the distinction between policies and products that affect either the accumulation or the so-called payout phase of the retirement program. Furthermore, there are considerations of investment policy, investment risk diversification, and investment performance. All of the above- mentioned elements are intertwined, yet they may also be viewed as separate issues.

The Committee recommends the following program changes to the TIAA-CREF pension system:

A. Rollover, Transfers, and TIAA-CREF

The Committee believes that the rollover and transfer of funds from TIAA to CREF and to other retirement plans, and from CREF to other retirement plans, should be permitted at any time as a matter of general policy. More specifically, we recommend that TIAA-CREF:

1. Permit transfer of CREF accumulations to other retirement plans immediately; and

2. Permit rollover of TIAA accumulations to CREF, and transfer of TIAA accumulations to other retirement plans--with proper regard to and compensation for the costs of disintermediation--as soon as possible.

B. Payout Options

The Committee also recommends the following three new changes:

1. Increase the Retirement Transition Benefit (RTB) from the current 10 percent to a higher level;

2. Establish a distribution option that would allow a participant to choose an installment payout, ranging anywhere from a 5- to a 20-year settlement; and

3. Introduce an interest-only payout (to an age certain) option.

C. Investment Alternatives

The Committee believes that TIAA-CREF must offer its participants a wider variety of investment and risk alternatives than are currently available or contemplated. These are:

1. A money market fund (already planned);

2. A fund of publicly traded bonds;

3. A group of equity funds with the following objectives:

   a. A fund striving for somewhat less volatility than the present CREF, perhaps by stressing income-producing investments; and

   b. A fund for equity investments whose objective would be more aggressive capital growth and which would thus be directed to participants willing to assume a comparatively higher degree of investment risk.

4. A balanced (equities and bonds) fund.

The Committee believes that the recommendations above would restore the preeminent place TIAA-CREF once occupied within the pension industry. We have set forth these recommendations because we believe that TIAA-CREF should provide to its participants and to the sponsoring institutions as wide a variety of options as possible and maximum flexibility within the law.

We have concluded that there are no insuperable barriers, legal or otherwise, to any of the recommendations listed above. Our legal counsel's preliminary analysis supports our recommendations.

TIAA-CREF, on the other hand, has argued and reaffirmed to us its view that our recommended policy changes are precluded by three obstacles: (1) financial disintermediation, (2) state nonforfeiture laws, and (3) the difficulty of making changes in existing policyholder contracts.

The issue of financial disintermediation (withdrawing TIAA funds priced at book value when their market value may be different) is significant, and it requires more study. If TIAA accumulations could be marked to market, disintermediation would not be an issue. And as far as CREF accumulations are concerned, the disintermediation issue does not come into play at all. Thus, disintermediation risks do not affect CREF accumulations, which are always carried at market value; and it may well be possible to overcome these risks to TIAA accumulations also. The Committee believes that the TIAA disintermediation problem need not remain a permanent obstacle to change.

In any event, we believe that TIAA-CREF should cooperate with NACUBO in a comprehensive study of the disintermediation issue. On the basis of our discussions with legal counsel and others, we are not convinced of the validity of the second and third arguments set forth by TIAA-CREF.

We applaud TIAA-CREF's recent, as well as planned, program changes, in particular the "graded benefit option" (in the payout phase) and the forthcoming new money market fund (for new money and for CREF accumulations). These innovations provide participants with an increased degree of flexibility. Another innovation, the Group Retirement Annuity (GRA), planned for new money, is not endorsed or opposed by this Committee because of uncertainties surrounding it. Whether a "cash-out" feature is appropriate to retirement plans is subject to debate; it is not the purpose of this report to take a position on the issue.

We understand that TIAA-CREF has no plans to offer additional options for the money currently invested with the organization. The Committee, therefore, recommends that NACUBO offer general aid and coordination to colleges and universities exploring alternatives to TIAA-CREF. This would assist all persons and institutions in developing the appropriate additional flexibility and options, particularly for longstanding participants.

Recommendations

The Committee's report concludes with recommendations and comments:

1. That NACUBO maintain an ongoing committee to monitor, and report on, the pension plan scene in higher education. The committee's future agenda should include the following TIAA-CREF issues:

a. Investment management and performance measurement; and

b. "Blue and Yellow" reporting forms and other communications.

2. That TIAA-CREF establish an Ombudsman's Office to resolve complaints.

3. That a review of annual performance (and risk factors) of major firms that offer 403(b) retirement plans be conducted, perhaps by NACUBO.

4. That NACUBO provide general assistance and coordination to institutions considering alternatives to TIAA-CREF.

5. That NACUBO maintain a close relationship with the Commission on College Retirement.

6. That NACUBO seek funds to study the disintermediation question, with cooperation from TIAA-CREF.

Comments

7. Current reporting practices of TIAA-CREF are incomplete and inadequate with respect to investment performance, individual account information, and projections of future benefits. We have already begun discussing this subject with TIAA-CREF.

8. The Committee has already begun discussing with TIAA-CREF the broad issue of communications. We commend the recent opening of more field offices, we recognize and appreciate the massive communications effort that TIAA-CREF conducts, and we are proceeding in detailed discussions with that organization's staff.

9. A number of TIAA-CREF governance issues need to be considered and questioned, and certain practices perhaps changed.

10. The need for financial counseling is acute. Expert, independent, low-cost service to institutions and their personnel is clearly desirable and should be studied by the Ad Hoc Committee and perhaps by the Commission on College Retirement.

11. Training and support of campus business and personnel officers need greater attention. These individuals need help they are not getting. This area also needs further examination by TIAA-CREF, NACUBO, and perhaps by the Commission.

Text of Full Report

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Preface

The Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) retirement plans have played an historic leadership role not only in the nonprofit sector, particularly in higher education, but for the pension industry in general. Established in 1918, TIAA was a leader in the development of defined-contribution retirement plans and of the concepts of portability and full and immediate vesting of plan contributions and pension benefits. CREF, which was chartered in 1952, gave credibility and national recognition to the variable annuity and focused attention on the benefits of equity investments in building retirement capital. Even the 1974 Employee Retirement Income Security Act (ERISA) owes a debt to the pension and investment principles embodied in TIAA-CREF.

Both TIAA and CREF were influential because, when established, they were an exemplary combination of soundness and innovation. Today TIAA-CREF is the nation's largest nonfederal pension plan, with about 750,000 active participants and about 135,000 retirees and other beneficiaries; TIAA-CREF serves 3,600 institutions, including over 90 percent of all independent colleges and universities, as well as public institutions in 34 states. With assets of over $30 billion, the organization is growing by $2.5–$3 billion a year from new contributions, not counting investment income. It is one of the largest money management companies in the United States.

In the last 10 years a revolution of sorts has occurred in the financial marketplace: previously unavailable investment and tax deferred savings opportunities abound, and individuals in vast numbers and a growing number of institutions are taking advantage of them. Unfortunately, TIAA-CREF has not continued its historic leadership. Not surprisingly, TIAA-CREF's failure to explore the new financial opportunities or to offer a convincing explanation for its lack of movement has led to concern among participants.

That concern is all-encompassing: it includes TIAA and especially CREF investment performance, customer relations and "back office" procedures, the organization's limited investment options, and inflexible policies in the face of rapidly changing retirement and investment industries.

Concerns over TIAA-CREF's ability to respond to the market and to the needs of its participants are real. This Committee has heard from many individuals and institutional representatives who believe that TIAA-CREF's inflexibility and its reluctance to develop products similar to those now being offered by its competitors will penalize them during their retirement years. This Committee believes that TIAA-CREF can, and should, do more to develop and offer options much like those now being offered by its mutual fund and insurance company competitors, which are beginning to attract a significant number of retirement dollars away from TIAA-CREF. Indeed, our limited sample of institutions that are allowing other options suggests that up to 30 percent of participants and 30 percent of retirement dollars are being directed toward these new plans and away from TIAA-CREF.

Having been established and originally supported by a foundation to serve higher education, TIAA-CREF is not simply the manager of the retirement funds, but has the special obligation to respond to the legitimate concerns of the individuals and institutions now asking for more options in both the working and retirement years.

Although flexibility is the focus of this first report, the Committee must point out other issues that should be addressed by TIAA-CREF and monitored by NACUBO:

- Investment management and performance measurement; and
- "Blue and Yellow" reporting forms and other communications.

forms and other communications.

Recommendations and comments on these and other issues are found in the conclusion to this report. (See also recommendations on page 22.)

The Committee

NACUBO established this Ad Hoc Committee on TIAA-CREF in response to the variety of concerns expressed by individual TIAA-CREF plan participants, by administrators in higher education, and by external observers of the pension plan scene. Personnel administrators and faculty, as well as business officers, are represented on this Committee. During its study, the Committee found it necessary to secure expert legal advice, and wanted to be sure that the recommendations submitted were sound and practical legally; so it. May it retained William T. Gibb, of counsel to Caplin & Drysdale, formerly chief counsel for taxes and pensions for the American Council of Life Insurance.

The concerns underlying the appointment of this Committee have concurrently led the Carnegie, Ford, Hewlett and Mellon Foundations to grant $1.5 million to establish the Commission on College Retirement. The Commission held its first meeting at the first of June and will issue a comprehensive report in about 18 months. The Commission's chairman, Oscar M. Ruebhausen, and its director, Thomas C. Woodruff, have had several discussions with us and we expect to remain in close contact, since we all wish to assure that no issue is inadequately treated (or ignored). We anticipate mutual benefit from a division of labor, keeping our Committee to its charter—TIAA-CREF and directly related issues—while the Commission pursues its broader objective—the vast area of college and university retirement, in general. Cooperation on issues of common concern may indicate some joint ventures.

The Committee's task is to submit to NACUBO a report and recommendations on the major issues surrounding TIAA-CREF: to examine the organization, to propose any changes we think warranted, and to suggest what we believe the higher education community should reasonably expect from TIAA-CREF. TIAA-CREF is virtually synonymous with pension policy in higher education, and if it responds appropriately to the needs of the community it will continue as the centerpiece of the campus retirement scene. Our purpose, therefore, is to spur the consideration of policy changes that we believe are essential for college and university employees—in short, to strengthen TIAA-CREF and move it toward a more enlightened approach to the retirement scene.

This Committee met with the policyholder-elected trustees of TIAA-CREF in November 1983, and since that time the two boards of trustees appointed a special Ad Hoc Committee on Goals, which has also met with us. We wish to express our gratitude to these individuals. We want also to thank Chairman James C. MacDonald and Executive Vice President John J. McCormack, and all the other TIAA-CREF officers and staff who have given generously of their time and expertise. Our task would have been impossible without their cooperation.

The Retirement Program

A growing number of TIAA-CREF participants, concerned about an adequate retirement income and aware that an inflationary economy will erode the value of their retirement dollars, are asking for a wider range of investment options than are currently available in the TIAA-CREF program. The employing institutions, in response to those requests and concerns that TIAA-CREF's program is limited, are reviewing alternative investment and retirement plans and in many instances are incorporating them into their total retirement program offering.

A basic assumption underlying this report is that the individual who is investing for retirement has the right to ask for more accumulation and distribution options. The individual policyholders, somewhat like corporate shareholders, have a voice in the management of TIAA-CREF through the members of the Board of Trustees, some of whom are their elected representatives.

At the same time we acknowledge that the institutions, which employ the individual policyholders and which chose TIAA-CREF as its principal retirement program provider, in some ways have the responsibility of providing the means for a reasonable retirement income for its employees.

TIAA-CREF, an organization partially governed by policyholder-elected trustees and selected by institutions to help provide a reasonable retirement benefit for the employee-policyholder, has an obligation to respond to the needs and concerns of both.

One purpose of this report is to try to determine through investigation and discussion if, indeed, TIAA-CREF is in a position to offer flexibility to its policyholders or if, in fact, disintermediation, legal problems and other considerations are truly obstacles that prevent change—especially where "old money" (money already invested) is concerned.

We have concluded, as a result of our discussions with TIAA-CREF officials and our own legal counsel, that it is not difficult at all to add some immediate flexibility for CREF accumulations. While it will be more difficult to change TIAA because of prevailing insurance practices, methods of determining asset values and potential disintermediation problems, there are no insurmountable obstacles to providing flexible options for TIAA accumulations. Later in the report, we recommend (page 20) that a new range of options be made available immediately for CREF accumulations and that the participant be permitted to transfer accumulations among those funds.

Our report urges both TIAA and CREF to listen to the expressed concerns of its policyholders and to look at the options being developed by the competition. Just as their mutual fund and other competitors offer a family of funds to meets the needs of a wide range of shareholders (age as well as economic circumstance), they too must diversify. One product for all ages and all participants cannot adequately meet those needs. Once the options are developed and incorporated into the TIAA-CREF program, the institution working with its employees can select those which best meet its needs.

Of one thing we are certain: many institutions and individuals are looking for more flexibility and more investment options than are now avail-

able through TIAA and CREF. If TIAA-CREF does not respond, it will lose its position as the centerpiece of college and university retirement programs. We do not want that to happen; the report, with comments and recommendations following, suggests that it need not happen.

Priority: Flexibility Issues

At its first meeting, this Committee determined that the TIAA-CREF issues that have received the most persistent and widespread attention and concern are those having to do with flexibility. Because we agreed on the priority of the flexibility issues, our work and this report deal almost exclusively with TIAA-CREF policyholder options. After comparing TIAA-CREF's retirement plans with alternatives available from other insurers (and other firms) offering 403(b) retirement plans, the Committee concludes that TIAA-CREF participants have relatively few investment or distribution options—the principal complaint of policyholders.

The Existing Situation

What, exactly, does TIAA-CREF allow? Perhaps better than any other way, Exhibit 1 illustrates the Committee's concerns. It shows the various investment and distribution options available from TIAA-CREF, for both "old" and "new money," and those generally available from other insurers and mutual funds.

Exhibit 1

	Other Organizations* Offering 403(b) Plans	TIAA-CREF	
		Old Money	New Money
Investment Options			
Money Market Fund	Yes	In 1986	In 1986
Bond Fund	Yes	No	No
Balanced Fund (Bond/Equity)	Yes	No	No
Equity Funds			
○Low Volatility	Yes	No	No
○Market-Level Volatility	Yes	Yes	Yes
○High Volatility	Yes	No	No
Transfer of Funds			
Among Available Options Within Organization	Yes	CREF to TIAA only (and in the planned new GRA; in 1986, in and out of money market for CREF, or money market to TIAA)	CREF to TIAA only (and in the planned new GRA; in 1986, in and out of money market for CREF, or money market to TIAA)
To Other Organizations	Yes	No	No
Distribution Options			
Annuities	Yes	Yes	Yes
"Graded Benefit" Annuity	No	Yes	Yes
Installment Payout	Yes	No	GRA only
Interest-Only Payout (to age 70½)	Yes	No	No
Lump-Sum Distribution	Yes	No	GRA only
Partial Lump-Sum Distribution	Yes	Up to 10% (RTB)	GRA only
Rollover to IRA	Yes	No	GRA only

*Insurance Companies and/or Mutual Funds

Flexibility for "Old Money"

Our immediate concern centers on TIAA-CREF's reluctance to increase flexibility for "old money," that is, the over $15 billion already invested in TIAA and the $15 billion already invested in CREF. As here treated, "old money" includes all investment income on the accumulations (over $2 billion last year) plus new premiums (almost $2.5 billion last year) until more options are adopted. A money market option for CREF, planned for 1986, will, we understand, permit CREF "old money" as well as CREF "new money" to move from CREF to the money market fund and back. TIAA, however, has no plans at all to add options for "old money." The only TIAA flexibility planned is the GRA "new money" option (a new plan) which will permit rollovers to IRA, installment payout and lump sum distributions. Our greatest concern must be for the vast proportion of participants' funds that are locked into the existing options.

We cannot ignore the fact that TIAA-CREF is overlooking the expressed concerns of this group of participants—people who are responsible for a much larger proportion of the TIAA-CREF assets. Those who are, say, 55 years old with 20 years or more of accumulations, or 45 years old with 15 years of accumulations, are frozen for another 10 or 20 years of the accumulation phase and, after that, frozen for several more years to several decades in TIAA annuities. At retirement, or settlement, the participant again has very limited choice. He or she may elect to take up to 10 percent of the accumulation in cash, the Retirement Transition Benefit (RTB). (Note: Roughly 20 percent of retirees are so electing, according to TIAA-CREF, yet this is not an insignificant number.) Otherwise, the only choice is which annuity to select from TIAA and/or CREF.

In short, many TIAA-CREF par-

ticipants remain captives of an unchanged product created when the annuity industry provided limited options. Now that same industry is bursting with innovative and competitive activity.

"Old Money" Options

Three hurdles, according to TIAA-CREF, preclude adding flexibility for "old money": (1) allowing transfer from TIAA to another funding medium would risk financial disintermediation, that is, the withdrawal of funds that must be accounted for at cost, when their market value may be less; (2) state nonforfeiture laws; and (3) legal problems related to changing existing contracts.

The first hurdle, disintermediation, is a concern for TIAA (but not CREF) and it clearly requires further investigation. Although insurance companies generally attempt to guard themselves against the adverse risks of disintermediation, they rarely, if ever, adopt the rigid approach taken by TIAA-CREF of simply prohibiting distributions altogether. While disintermediation is a legitimate concern for TIAA accumulations, there is no disintermediation risk at all to CREF's $15 billion portfolio—almost half the retirement assets. Our preliminary examination indicates substantial reason to believe that very real possibilities for change exist here. Toward that end, we have secured legal counsel for a complete examination of the issues at hand.

All of TIAA's assets are priced at cost value. Since assets are mostly long-term, fixed-rate investments, as interest rates rise the market value of the assets decline; and if participants could withdraw their funds at cost to earn the higher yields in other investment vehicles, substantial sums would likely be withdrawn. Such withdrawal would be likely if it could be made at valuations exceeding current market values.

Recent cycles of high interest rates have made many people, otherwise unsophisticated about finance, quite aware of disintermediation (whether or not they use the term) as they withdraw deposits from banks and savings and loan institutions to secure higher yields elsewhere, higher than those institutions can offer because of their tie to investments in long-term, fixed-rate mortgages. These institutions, however, are now responding to that concern over their vulnerability, and are greatly reducing their long-term fixed-rate mortgage commitments. TIAA's portfolio for the last several years has been using similar innovations and is now far less vulnerable to disintermediation. This is not to say that there is no problem here at all, but only that the area requires fuller, expert analysis and a plan to reduce the potential for a problem with disintermediation.

TIAA already allows cash distributions in certain instances: (1) SRA accumulations, on which there originally was, but is not now, a disintermediation fee; (2) death benefits to beneficiaries who can elect lump-sum distributions from TIAA; and (3) the forthcoming GRA, which will have a modest withdrawal charge. Indeed, we believe that overcoming the entire disintermediation hurdle may be possible and should be studied along the lines suggested below:

1. by analyses to determine just how much of a problem there is;

2. by considering what other firms have done to allow liquidity without risking the danger of disintermediation (for example, by imposing a withdrawal charge as is planned for the new GRA and/or requiring installment payments); and

3. by phasing in permission for gradual withdrawal so as to reduce the danger of disintermediation while portfolio holdings are adjusted to better protect the book value of investments with contemporary investments.

The Committee is not convinced that disintermediation is as great an obstacle for TIAA as it is made out to be. In any event, the disintermediation problem need not remain a permanent obstacle to increased TIAA flexibility and, as stated earlier, is no obstacle at all for CREF.

The second alleged hurdle barring revisions in the current TIAA-CREF contracts is state nonforfeiture laws. Under nonforfeiture provisions of insurance laws, particularly in New York, TIAA-CREF tells us that if a lump sum distribution is available at retirement or termination, then the full cash amount of the contract must be available at all times. If these state provisions were to come into play, says TIAA-CREF, then that organization would cease to be a pension plan, thus violating its fundamental purpose. (For that reason, it is said that rollovers or transfers to other retirement savings vehicles cannot be allowed because, according to TIAA-CREF, any movement of funds to a different firm, as in a rollover, is first a cash distribution to the participant.)

Having engaged legal counsel for a preliminary examination of the issues, the Committee believes that nonforfeiture laws are not an insuperable barrier to change, and further examination is underway. The consequences of change may need more exploration also, but here again, the Committee, after preliminary discussions with legal counsel, is not convinced that increasing policyholder flexibility would in any way imperil TIAA-CREF. Moreover, analysis and exploration of these questions cannot be aborted by fear of unlikely events that, even if any were to occur, would not likely result in losses that would outweigh the potential gains we anticipate.

The final hurdle asserted is that existing policyholder contracts cannot be changed retroactively. The Committee believes this argument is weakest of the three; our legal counsel suggests that this may be no barrier at all. We note that the RTB was a retroactive change (one we support and for which we urge expansion). The SRA introduced a change for "new money," allowing not only investment in but withdrawal (without charge) from TIAA, with disintermediation possibly injuring existing policyholders. Additionally, the U.S. Court of Appeals for the Second Circuit recently decided in the *Spirt* v. *TIAA-CREF* suit that TIAA-CREF policies offer no such expectation of any set retirement income as to preclude retrospective application of the unisex payout. That decision will be appealed by TIAA-CREF, but it suggests that the retroactivity problem is not an absolute barrier. It is instead, understandably, a matter of what precise change is at issue and what gains and losses, if any, would result.

In short, our interim view is that TIAA-CREF's defense of inflexibility is not well founded. We are not convinced that the only changes management can develop and the

law will allow are those that have already been made. Moreover, even if legal obstacles are found, the Committee believes that TIAA-CREF has the fiduciary responsibility to make efforts to secure legal change where change would be fruitful and where there exists a likelihood of success. Of course, we would urge NACUBO to join TIAA-CREF in such efforts.

Retirement Transition Benefit

During our several discussions with TIAA-CREF management, we asked why the RTB is currently limited to 10 percent and why that figure cannot be increased. We asked why rollovers or transfers—other than from CREF to TIAA—are not, nor will be, allowed. Disintermediation, not surprisingly, was the standard response. A higher RTB is said to run the risk of disintermediation (for TIAA perhaps, but not for CREF).

In the opinion of TIAA-CREF legal counsel, a 10 percent RTB was the limit. TIAA-CREF views 10 percent as *de minimis* and thus not as a cash option significant enough to trigger state nonforfeiture laws. However, TIAA-CREF told us that no written legal opinion exists that would hold the RTB to 10 percent—but then why not 11 percent? or 15 percent? Clearly, the question of how much may appropriately be cashed out must be considered in terms of the adequacy of the participant's total retirement income. Our dialogue continues.

We believe that the RTB could, and should, be raised to a level that would truly give participants with "old money" other investment options when retiring. And our initial recommendations pertaining to rollovers or transfers (for investment purposes) still stand, despite TIAA-CREF's arguments. We believe that TIAA-CREF will either not adopt appropriate flexibility for accumulated funds, or else not maintain such flexibility as innovations develop in the financial services industry, unless it faces the same competitive spur that others do, that is, allowing participants to transfer funds to other appropriate investment or annuity vehicles if they believe those others offer a better product.

Planned Options for "New Money"

We are pleased to note that TIAA-CREF recognizes that additional choices for "new money" are essential and appropriate, the organization having already taken some steps to increase flexibility by removing age restrictions and beginning to develop investment options for future TIAA-CREF premium dollars. First: beginning in July 1984, for the first time TIAA-CREF will allow unlimited transfer of CREF accumulation units to TIAA without the previous 55-year-or-older limitation. Transfers from TIAA to CREF, however, will continue to be prohibited. Second: the same 55-year-or-older limitation likewise has been removed from the Retirement Transition Benefit. Third: starting in September 1984, TIAA-CREF will offer a new Group Retirement Annuity (GRA) which will be available for institutions that are able, and choose, to adopt it. The GRA, which will apply only to future premium dollars, will allow participants, upon retirement or termination of employment, to "cash out" their accumulations, or to transfer them to another savings or annuity vehicle, or to take an annuity. Fourth: starting in January 1986, participants will have a money market investment option as well as the TIAA and CREF funds, and possibly an innovative money market annuity as well.

TIAA-CREF's money market fund is truly a welcome alternative, especially since it will be available for "old" CREF money as well as for all "new" CREF premiums. The new money market fund, when offered, will be a rider to CREF contracts and the TIAA-CREF accounting system will move from a monthly to a daily system. It has taken a long time to implement the new fund, according to TIAA-CREF, because the accounting-related procedures and data system changes necessary to service the 800,000 participants must all be in place before the new program begins.

The plan, as we understand it, will allow free transfer between the new fund and CREF, and free transfer from the new fund to TIAA. This added option and flexibility will be useful during the recurrent periods when short-term interest rates seem unusually high. Such periods have occurred several times in the last 10-15 years. Money market funds grew from under $4 billion in assets in 1976 to about $210 billion in 1982, and are now at about $165 billion. In these periods, it is not unreasonable for people to believe that the virtually riskless high yield returns from such a fund may be desirable alternative investments and attractive for diversification. Some people, particularly those nearing retirement, may want to use the money market option when they believe that the stock market has moved so high that they should freeze or reduce the amount of their CREF holdings. At present, the only option is a switch into TIAA, but once dollars flow into TIAA they cannot be transferred out. Having the choice between CREF and a money market option will add significant flexibility. A third reason for adding the money market accumulation option is that it is available from many other investment management firms, is attractive to so many people, and is one of the principal reasons institutions and individuals are directing some of their retirement money away from TIAA-CREF.

We are disappointed, though, in the current timetable for implementation of these options. While we understand the complexities in developing the records base and the need to properly register any new options with the appropriate agencies, we strongly urge TIAA-CREF to do whatever is necessary to make at least one of these options available no later than mid-1985 and to announce the new option as soon as possible. Further, we hope that the state of TIAA-CREF records, accounting, data processing systems, and management information systems is drawing the appropriate attention at the Board of Trustees level.

We doubt there is anyone who does not applaud TIAA-CREF's steps to increase "new money" flexibility. We hope that the trustees' Ad Hoc Committee on Goals is considering additional new options, but we have been unable to learn if, in fact, the issue of flexibility is one of its major concerns.

Group Retirement Annuity

TIAA-CREF has announced that it will add a "new money" option in September 1984. The GRA will give participants the option of taking a full or partial lump sum distribution either at retirement or termination of employment. A 2.5 percent disintermediation fee will be charged on withdrawals from the GRA; no charge will be made if participants select a payout distribution option of from 5 to 20 years.

A troubling point about the planned GRA is that, based on our preliminary examination, few institutions are currently in a position to be able to take advantage of that option. First, one of TIAA-CREF's arguments for not allowing various "old money" options is that many states originally allowed their employees the choice of TIAA-CREF with the understanding that the TIAA-CREF plans would not have a "cashout" feature. How then can state institutions use GRA, which allows cashouts?

Institutions should be aware of the problems which can be created as they attempt to qualify the new GRA option. Unless the GRA is properly established, many of the tax advantages available may be disqualified. Congress recently passed a tax bill that generally facilitates rollovers and cashouts. Review of the new law is underway.

Lump-Sum Options: Arguments For/Against

The annuity-only option is predicated on two beliefs: The first is that some employees will use lump-sum distributions either imprudently or, however prudently, unsuccessfully. The annuity-only option protects the institution from pressure from those employees who do, in fact, have inadequate funds to sustain retirement. The second belief is that college retirement plans, and TIAA specifically, were established not only to benefit persons retiring but also to assure that retirement income would not be inhibited by financial exigency, and retirement would occur frequently enough and early enough to keep the professoriate from being too old at the senior level, and from having too few openings at the entry level. Allowing cashout at transfer from teaching at College A to teaching at College B thus runs the risk of College B's having to retain — or sustain—the teacher who cashed out for a longer period of time than if career retirement savings had been in place to assure a full annuity.

Some institutions, and many individuals, do not share those views. And all might agree that the annuities-only policy should recognize more exceptions than the single one already in place (participants with less than $2,000 or five years' participation can withdraw). For example: (1) Should not participants with no heirs and clear medical prognosis of extremely limited life expectancy be entitled to use their accumulation if their institution concurs? (2) If participants or individuals can secure better annuity terms than TIAA-CREF offers, should they not have the opportunity to select that option? (3) If a participant has left academe for a period so substantial as to make any return unlikely, is it not appropriate to allow his or her withdrawal?

But this Committee would act imprudently if it took a stand now on the issue of cashout provisions to be provided by GRAs.

First, TIAA-CREF officials have indicated that, despite the fact that the plan will be offered in September, they do not believe it is sound retirement policy. Second, most institutions that have already added alternatives to TIAA-CREF have restricted the availability of cash; they do not think the best interests of the participants or the institution is served by such an option. Only a handful to date have opted for cashout. Third, the American Association of University Professors (AAUP) and the Association of American Colleges (AAC) issued a 1980 Statement of Principles that called for annuity-only provisions in college retirement plans. That statement may be outdated, and doubtless will be reconsidered, but it cannot be ignored.

Additional Needed New Options

This Committee concludes that the investment vehicles in the present TIAA and CREF programs are not adequate to meet the needs of most individual participants. Other financial services organizations offer "families" of funds with both greater flexibility for transfer during the accumulation period and a broader variety of distribution alternatives at retirement than currently available from TIAA and CREF. Our recommended alternatives are intended to make TIAA-CREF a truly contemporary investment program that would offer a broad range of choices and provide flexibility and control that many policyholders want and need in their retirement program.

Flexibility Options

Establish a range of investment alternatives for the widely diverse body of policyholders, including the following:

—A money market fund (already scheduled for 1986);

—A fund of publicly traded bonds, marked to market, (especially if TIAA continues to bar withdrawals);

—An equities fund with capital growth as an objective, aimed largely at younger policyholders or other participants ready to take higher risk;

—A balanced fund, to relieve or reduce participants' burden of allocating assets among the various alternatives;

—An equities fund with lower volatility than CREF, aimed especially at participants in or nearing retirement; and

—The option to transfer accumulations among these funds.

Permit rollover of accumulated TIAA-CREF funds, at any time, to other alternative retirement plans with different (and generally more flexible) investment and distribution options.

Permit transfer of accumulations from TIAA to CREF at any time.

Increase the Retirement Transition Benefit (RTB, or cash available upon retirement) from the current 10 percent to a higher level.

Establish a 5 to 20 year payout option (installment payout plan) for all policyholders.

Establish an interest-only (to an age 70-1/2) payout, if possible.

The money market fund and the GRA are the only new options that

TIAA-CREF has approved, although neither is yet in place. The organization is considering other options, primarily for "new money," which it would be unfair to ignore and that we fully support. These include a bond fund, multiple equity funds, and possibly an interest-only (to an age certain) payout option.

As part of a truly diversified investment approach, a bond fund is essential if TIAA continues to prohibit transfers, and is perhaps desirable in any event. Income in a bond fund should be higher and more stable over a long period of time than funds in a money market account, but principal value fluctuates. As interest rates rise, principal declines; as rates fall, principal increases.

A growth and equities fund, with a risk higher than the existing CREF portfolio, would likely appeal: (1) to the younger TIAA-CREF policyholder anticipating 20 or 30 more years in the system, who might be willing to assume greater investment risk in hope of potential large gains, or (2) to the participant of any age who is simply willing to undertake greater investment risk. Last, a balanced fund would serve those policyholders who do not choose to allocate their retirement savings among multiple investment vehicles, and who would prefer to place assets in a fund in which qualified professionals make such choices.

Lowering the Volatility of The Variable Annuity

CREF's introduction in 1952 was for the purpose not only of offering participants an opportunity to save for retirement with common stocks as well as with fixed-income investments, but also to offer annuitants the opportunity to have at least some of their non-Social Security retirement income based on common stock investments. The option recognized the value of diversification of retirement fund assets and the need for flexibility by permitting the participant to determine the percentage of the premium dollar to be allocated to CREF and to TIAA.

The booklet *CREF Units at Work* explains, "... CREF was established to provide variable annuities—retirement income based primarily on investments in common stock—to complement TIAA retirement income, which is based on investments in bonds, commercial and industrial mortgages, and real estate. The purpose of the combined program is to provide retirement income that is more responsive to economic change than a traditional annuity alone and less volatile than an annuity income based primarily on common stock experience."

During the decade of the 1970s, the CREF annuity unit, the unit that determines the retirement dollar payout for 12 months at a time, was quite volatile and affected retirement income much more than was anticipated. While this is all to the good in an "up" year, like the recent annuity unit increase of 39 percent, the variability has been considerable: since 1972, CREF rose in four years and fell in six, with the the peak rises at 39 and 37 percent (1983 and 1981) and one fall as substantial as 33 percent (1973).

Annuitants who prefer to have some stock-based income—a variable annuity—need to have more stability and predictability of retirement income than CREF currently offers.

Hans Jenny, a member of this Committee, has written and spoken urging that CREF adopt some valuation technique that would "smooth" fluctuation in the annuity units. Professor Zvi Bodie, of Boston University, has published two analyses, "An Innovation for Stable Real Retirement Income" (*Journal of Portfolio Management*, Fall 1980) and "Retirement Annuity Design in an Inflationary Climate" (NBER Working Paper 896, May 1982).

In addition to alternative valuation methods, consideration should be given to offering a more conservative stock fund that may not have the growth potential desirable for young participants, but that would have the stability likely to serve not only retirees' needs for a more stable stock-based income, but also the need of persons within a few years of retirement who may wish to avoid the danger of a sharp drop in stock values in the more volatile CREF portfolio. Those pensioners may wish to retain the opportunities for some future principal growth by retaining a stock-fund annuity rather than switching their units into a TIAA annuity.

Alternatives for Colleges And Universities

After much discussion with TIAA-CREF officials and within the Committee, we recommend that NACUBO provide general aid and coordination to institutions exploring alternatives to TIAA-CREF. Perhaps this report and future reports from the TIAA-CREF trustees Committee and from the Commission on College Retirement will help persuade the organization that additional flexibilities for longstanding participants should be developed. Now, however, nothing is forthcoming for "old money," except for transfers between CREF and the planned money market fund. Even for new in-flows to TIAA-CREF, flexibility is being added more slowly and less fully than by other firms offering 403(b) plans.

In their review of alternatives, institutions should not drop TIAA-CREF altogether—on the contrary. We repeat our view that TIAA-CREF is, and will likely continue to be, the primary retirement savings vehicle and annuity provider for higher education. We know of no institution that has even considered abandoning TIAA-CREF, and we agree that such a step would be unwise since it reduces the very flexibility that is properly in demand. At this point, however, competition may well be the surest way to improve TIAA-CREF's product.

Once an institution decides to explore options, it must proceed cautiously, and the decision should involve trustees, faculty, and administrators. Many institutions at first consider options only for supplementary retirement contributions, and numerous colleges and universities have, indeed, added alternative programs in that area. Their thinking is to add supplementary options first, then perhaps to consider options under the basic plan.

If an institution plans to review options at all, we believe it wise to consider not only supplementary but also basic retirement savings at the same time. The administrative effort necessary to establish the options for supplementary savings involves the very same steps needed for basic savings, but serves only a small proportion of the population. That group

may need less support than the much larger number of faculty and staff who can do no supplementary saving. We recognize that the institution's fiduciary obligations indicate caution, but we believe it is more prudent to start with a limited number of options than with a limited number of employees who may benefit from the new range of choice.

Conclusions

The Committee believes there is ample evidence of widespread discontent with many of the policies and practices of TIAA-CREF in recent years. A pension system that once was impeccable has had its image damaged severely, largely by its failure to respond to a changing environment, the sharp drop in the stock market, and partly by a paternalistic treatment of participants and participating institutions.

Within the past six months, following a change in the leadership of TIAA-CREF, it appears that the current administration has recognized that there may well be some fire beneath the smoke that has been swirling about them. Members of this Committee have met with various TIAA-CREF officials on numerous occasions and there has been an expression of willingness to continue the meetings and discussions in the future.

This Committee has identified and explicated at some length what it believes to be the *central theme for TIAA-CREF: flexibility*. The lack of options both during the accumulation period and during the payout period is of genuine concern to the membership. While modest progress has been made to date, much more remains to be done, and we must remember that flexibility is only the first issue on our agenda, albeit the most important and complex.

Recommendations and Comments

The Committee believes that if TIAA-CREF fails to respond meaningfully, for both participants and those who must administer the programs in the field, it will eventually lose its position of eminence on American college and university campuses. The Committee hopes that this does not happen. We would much prefer to be an advocate for TIAA-CREF, rather than a critic. We conclude this first interim report with the following recommendations and comments.

1. The Committee recommends that the NACUBO Board of Directors maintain an on-going Committee to monitor, and report on, the evolving pension plan scene in higher education and specifically to provide liaison between the campus business officer and those organizations, including TIAA-CREF, that provide retirement plans for colleges and universities. Retirement plans and retirement planning are undergoing significant change, and an appropriate monitoring group is essential now and for the future. NACUBO has taken a leadership position and has gained the attention not only of the leadership of TIAA-CREF, but of many others in the field of higher education who share the concerns expressed by campus administrators. We recommend that NACUBO continue its commitment on behalf of the entire interested community—faculty members, support staffs, and administrations throughout the country.

2. Public awareness of this Committee's existence has drawn us correspondence from individual TIAA-CREF participants and conversations with representatives of other organizations in the field of higher education. We have become aware of procedural problems that suggest what may well be undue rigidity on the part of TIAA-CREF. In some instances we find routine practices by TIAA-CREF that appear to cause avoidable difficulty and even hardship for participants. We recommend, therefore, that TIAA-CREF establish an Ombudsman's Office, reporting directly to the Chairman and with authority only to recommend, if the Ombudsman finds appropriate, both different resolutions of particular controverted matters, and new routines.

3. In the past few years, a significant number of institutions have added alternatives to TIAA-CREF for supplemental as well as basic retirement savings. We believe that all institutions with alternatives should periodically review them (including TIAA-CREF). Moreover, while much attention has been given to relative performance over long periods, too little attention has been given to relative levels of risk. Performance information should, as a routine matter, be accompanied by more detailed information about the portfolio's relative riskiness rather than mere textual statements of a fund's investment goals. We recommend a coordinated annual review of major firms offering 403(b) plans, perhaps using a NACUBO committee and an outside consultant. Otherwise each institution would either have to review virtually the same firms on its own, or run the danger of no review.

4. The Committee recommends that NACUBO provide general aid and coordination to those colleges and universities that are examining alternatives to TIAA-CREF.

5. The Committee recommends that NACUBO maintain a close relationship with the Commission on College Retirement. We believe NACUBO can provide significant input to the Commission's deliberations, and that NACUBO can have its perspective enriched by the Commission's work. We believe that NACUBO should attend carefully to the progress and reports of the Commission.

6. Because of the significance and complexity of the disintermediation issue, we believe it is essential to have an independent consulting firm, expert in the kinds of investments TIAA holds, study this matter, and we recommend that NACUBO seek funds for such a project. Of course, a study of this nature can be conducted only with the complete cooperation of TIAA.

7. In addition to the flexibility issue and all its ramifications, this Committee is concerned about consistent and meaningful reporting. Present practices of TIAA-CREF in this regard are incomplete and inadequate with respect to investment performance, individual account information and realistic projections of future benefits.

8. The Committee has already begun discussing with TIAA-CREF the broad issue of communications. We commend the recent opening of more field offices, we recognize and appreciate the massive communica-

tions effort that TIAA-CREF conducts, and we are proceeding in detailed discussions with that organization's staff.

9. We are concerned also that there is a lack of competition and diversity of approach in the management of the portfolios. The leadership of TIAA-CREF is, we believe, too quick to dismiss the employment of outside managers for a portion of these massive assets. The assertion by TIAA-CREF that outside managers would necessarily cost more and could not be relied upon to produce a better result is, we believe, subject to legitimate challenge. TIAA-CREF should consider giving participants the option of participating in a fund managed by other managers.

10. We have not yet discussed the issue of governance of TIAA-CREF. There are a number of issues here to be considered and questioned, and, perhaps, there are practices to be changed. The trustees of TIAA and CREF must accept at least some responsibility for the general concern that brought about the existence of this Committee.

11. The extraordinary proliferation of methods of saving, such as IRAs and other voluntary tax-favored vehicles and also new forms of annuities, has substantially increased the need for financial counseling not only near retirement but also much earlier. This need, now seen as acute in many places, may be most apparent at institutions that have added alternatives to TIAA-CREF. Expert, low-cost independent counseling particularly designed for college and university personnel seems clearly desirable, and we understand will be examined by the Commission and also by this Committee.

12. At present, significant decisions concerning financial well-being at retirement are all too often made with the precision of a roll of the dice, simply because there is no one available to aid in the decision with the kind of advice that can be rendered by well-informed, well-trained individuals. The function of training and support for the business officers and personnel officers in the field, especially at small colleges, needs greater attention with more emphasis placed on the campus benefits administrator. Given the current and ever-increasing offerings of new options and products, assistance must be provided to help administrators cope with such increased complexity. Furthermore, the number of faculty and other employees who will be retiring between now and the end of the century dwarfs past experience and will overwhelm current benefits administration staffs and current methods of operation on most campuses. These staffs need help, and they are not getting it in adequate measure. This, too, is an area that needs further examination by TIAA-CREF, by NACUBO and perhaps by the Commission on College Retirement. ◆

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